



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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DATE: 16 JUNE 2004
MEMO TO: MEMBERS OF THE IFAC PUBLIC SECTOR COMMITTEE
FROM: PAUL SUTCLIFFE AND MATTHEW BOHUN
SUBJECT: **ITEM 11 GFS, ESA IPSAS HARMONIZATION**

ACTION REQUIRED

The Committee is asked to:

- **review** and **approve** the draft project brief for the General Government Sector Project.

AGENDA MATERIAL:

11.3 Project Brief – General Government Sector

Pages
11.4 – 11.11

BACKGROUND

At the last PSC meeting, the Committee reviewed the recommendations of Working Group I (WGI) of the Task Force on Harmonization of Public Sector Accounting (TFHPSA). WGI recommended that:

- the PSC should allow and encourage note disclosure of financial information about the general government sector as defined by the *Government Finance Statistics Manual 2001* (GFSM 2001);
- the PSC should activate a long term project on developing a comprehensive report of financial performance which distinguishes between transactions and other economic flows as defined in GFSM 2001 as far as possible; and
- the PSC should require or allow the adoption of current values in IPSASs.

The PSC agreed to action projects dealing with disclosure of financial information about the general government sector and comprehensive performance reporting as resources allowed. The PSC also agreed to consider the final recommendation as it progressed the IPSAS – IFRS/IAS harmonization project. The status of work on the project briefs is outlined below.

ISSUES

(i) General Government Sector

The GFSM 2001, the *European System of Accounts* (ESA 95), the *ESA95 Manual on Government Deficit and Debt* (EMGDD) and the *System of National Accounts 1993* (SNA

93) require institutional units¹ in the general government sector (GGS) to present financial information in respect of the general government sector.

The IPSASs do not contain any provisions in relation to the GGS. The Committee agreed to the WGI recommendation to permit or encourage entities to disclose GGS information in whole-of-government general purpose financial statements prepared using IPSASs. The PSC directed staff to prepare a project brief for consideration at this meeting.

The Committee agreed that WGI should be invited to form a project advisory panel to provide input to staff in drafting the Exposure Draft. Ian Mackintosh, Chair of WGI, updated WGI members of the decisions taken by the PSC at its March 2004 meeting. Ian also extended the Committee's invitation to join the PAP – Staff have had positive responses to this invitation from several PAP members.

The project brief is attached at item 11.3. It outlines the project's background and objectives, and identifies key issues that need to be resolved in preparing the first draft of an Exposure Draft. Staff recommendations have been provided for each key issue. Members are requested to review the project brief and confirm or otherwise staff proposals regarding the key issues and project timing. Members are also requested to identify any additional issues that need to be resolved or discussed at this stage. Following this meeting, staff will provide PAP members with an update on Committee decisions and deliberations, and seek their reaction thereto. If the project brief is approved, it will be forwarded to other IFAC committees so that they can determine if it is appropriate for them to provide input to the project at its developmental stage.

(ii) Performance Reporting

International Public Sector Accounting Standards (IPSASs) are based on International Accounting Standards to the extent that these are relevant to the public sector. The IPSASs require public sector entities to prepare general purpose financial statements that present financial information about the financial position, performance and cash flows of an entity that is useful to a wide range of users in making and evaluating decisions about the allocation of resources.

WGI recommended that the PSC should activate a long term project to develop a comprehensive report of financial performance that distinguishes between transactions and other economic flows as defined in GFSM 2001 as far as is possible. The PSC agreed that a performance reporting project was important and should be activated. The PSC also noted that:

- the IASB had actioned a project on “Reporting Comprehensive Income”, but that progress on that project had been delayed; and
- in the development of the performance reporting project it would need to be cognizant of developments in the IASB's projects and balance its twin objectives of harmonizing with IASs/IFRSs and with statistical financial reporting bases.

¹ An “institutional unit” is defined as a “an economic entity that is capable, in its own right, of owning assets, incurring liabilities and engaging in economic activities and in transactions with other entities.” (SNA 93, paragraph 4.2)

Staff are developing a project brief on comprehensive performance reporting to reflect the recommendations of WGI. Staff have not completed the brief as yet. As members are probably aware, the IASB has now reactivated its performance reporting project and is establishing an Advisory Panel to provide input to the project. While acknowledging that the PSC agreed with WGI that it is not necessary for the PSC to await the outcome of the IASB Reporting Comprehensive Income Project before actioning its own project, staff believe it is appropriate to get a better feel for the IASB project and the potential for any overlap before finalizing the proposed project brief.

At its last meeting the PSC noted that it may be appropriate to progress this project with input from a Steering Committee. Staff would like to explore the potential for IASB representation on any such Steering Committee. Such representation will assist to minimize the potential for any unintended differences between GAAP and statistical bases of financial reporting in this respect.

Staff will follow up with the IAASB and provide a verbal update on any feedback at the July PSC meeting. Staff intend to finalize the brief for consideration by the PSC at its November meeting.

Paul Sutcliffe
TECHNICAL DIRECTOR

Matthew Bohun
TECHNICAL MANAGER

INTERNATIONAL FEDERATION OF ACCOUNTANTS
PUBLIC SECTOR COMMITTEE
PROJECT BRIEF

Disclosure of Financial Information Related to the General Government Sector

Background

The *Government Finance Statistics Manual 2001* (GFSM 2001), the *European System of Accounts 1995* (ESA 95), the *ESA95 Manual on Government Deficit and Debt* (EMGDD) and the *System of National Accounts 1993* (SNA 93) require governments to publish comprehensive information about “General Government Sector” (GGS). GFSM 2001, ESA 95, EMGDD and SNA 93 define the GGS as “The group of units consisting of all resident government units and all resident nonmarket nonprofit institutions that are controlled and mainly financed by resident government units”.¹ Financial information presented about the general government sector is referred to as “government finance statistics” (GFS).

The GGS includes entities such as government departments, law courts, public educational institutions, public health care units and other government agencies. The financing of these entities is sourced primarily from the government’s taxes, similar revenue and borrowings, rather than from the sale of goods or services. Whilst the definition of GGS only includes resident government units, however “foreign” GGS operations are generally considered domestic operations located within national enclaves in a foreign country, therefore effectively all GGS units, regardless of location, are within the scope of GFS. The GGS excludes “public non-financial corporations” (PNFCs) such as government business enterprises that trade in goods and services and “public financial corporations” (PFCs) such as central banks. Where GFS financial statements are presented for the PNFC and PFC sectors, they exclude any foreign operations of those sectors. Information about those foreign operations is presented elsewhere in the national accounts.

Current IPSASs do not require entities to disclose information about the GGS in their general purpose financial statements. IPSASs require entities to prepare general purpose financial statements that include information about all the resources controlled by the reporting entity. IPSAS 18 also requires entities to identify segments and present information about those segments.

Working Group I (WGI) of the Task Force on Harmonization of Public Sector Accounting (TFHPSA) recommended that the PSC consider explicitly allowing the disclosure of financial information for the GGS, as defined in GFSM 2001, in whole of government general purpose financial statements. WGI also recommend that the PSC specify rules to be followed by a government electing to disclose GGS information in its

¹ See for example GFSM 2001 *Glossary*.

general purpose financial statements. WGI stated that the presentation of GGS financial information is important as a means of facilitating the convergence of international public sector accounting. The PSC agreed to action the project as proposed by WGI.

Project Objective

The objective of this project is to develop an IPSAS that allows/encourages entities to disclose financial information in respect of the GGS in general purpose financial statements. The IPSAS will be applied by entities adopting the accrual basis of accounting and electing to disclose GGS information in their general purpose financial statements.

After completion of the IPSAS, the PSC may then consider whether to amend the Cash Basis IPSAS to include disclosures to be encouraged of entities applying the Cash Basis IPSAS *Financial Reporting Under the Cash Basis of Accounting*.

Operating Procedures

The IPSAS will be developed by the PSC at Committee level, with input from a Project Advisory Panel (PAP). The PSC follows a formal due process for the development of IPSASs. That process involves the preparation and issuance for comment of an Exposure Draft that identifies the proposed requirements of an IPSAS. The PSC will then fully consider any comments received in the process of finalizing the IPSAS.

The role of the PAP will be to provide input to PSC staff on key issues to be dealt with by the IPSAS, and to operate as a sounding board to staff in the exposure draft development process. Communications among the PAP members and PSC staff will be by electronic means.

The PSC agreed that the members of WGI be invited to form the PAP. WGI developed the matrix comparing IPSASs, GFSM 2001 and ESA95/EMGDD/SNA.

Project Timetable

- 2004 Action project, agree Project Brief, form Project Advisory Panel
- 2005 Develop and finalize Exposure Draft
- 2006 Issue ED and Review Responses to ED, commence preparation of IPSAS
- 2007 Develop and Issue IPSAS

Key Issues and Staff Recommendations

Should the IPSAS apply to all entities or only to those presenting whole-of-government general purpose financial statements?

Staff Recommendation

WGI recommended that an IPSAS be developed for whole-of-government general purpose financial statements. GFS information is cast at the whole-of-government level and is required to be compiled only at that level. IPSASs generally apply to all public sector entities. However, it is only possible to get a full representation of the GGS at the whole-of-government level. As such, it is appropriate that this IPSAS only apply to entities preparing whole-of-government general purpose financial statements. National, state/provincial or local governments could apply the IPSAS because GGS information may be useful for statistical purposes at those levels.

Staff recommend that the IPSAS should only be applied by entities preparing whole-of-government general purpose financial statements under the accrual basis of accounting using IPSASs.

Should the disclosure of GGS information and information about other sectors be mandatory?

Staff Recommendation

WGI recommended that disclosure of GGS information be allowed or encouraged. The PSC agreed with this recommendation. Staff noted that the benefit of the disclosure of GGS information is that it would allow the link between IPSAS information and GFS data to be established in jurisdictions where GFS is widely published. Disclosure would also enable GFS stand-alone data to be extracted from general purpose financial statements. The compilation and presentation of GGS data of sufficient quality to satisfy general purpose financial statement and related audit requirements will add to the workload of preparers and the complexity of the GPFS. In some jurisdictions users may not demand the disclosure of GGS information, and it seems unnecessary to make disclosure of GGS information mandatory in such circumstances.

Staff recommend that the IPSAS be developed on the basis that the disclosures are encouraged, not mandatory, and that the IPSAS note that information may also be presented about the PFC and PNFC sectors using the same rules as for the GGS.

What prominence should be given to GGS disclosures in the general purpose financial statements?

Staff Recommendation

WGI recommended that the PSC consider the prominence that should be given to GGS disclosures in the general purpose financial statements. The choices that are available are

to make the GGS disclosures a primary financial statement, or to include them in the notes to the general purpose financial statements. IPSAS 1 *Presentation of Financial Statements* identifies the primary financial statements as:

- The Statement of Financial Position;
- The Statement of Financial Performance;
- The Statement of Changes in Net Assets/Equity; and
- Cash Flow Statement.

IPSAS 1 clearly identifies information that is to be disclosed in the notes to the general purpose financial statements. Staff are of the view that the prominence of the primary financial statements should not be diminished and that the demarcation between the primary statements and the notes be maintained.

Staff recommend that the disclosure of GGS information should be in the notes to the financial statements, particularly as the disclosure will not be mandatory.

If disclosure of GGS information is made, should the IPSAS prescribe the basis for disclosure?

Staff Recommendation

WGI recommended that the PSC specify rules to be applied where a government elects to disclose GGS information in its general purpose financial statements.

GFS and IPSASs have many similarities, but there are also differences in approaches taken to the measurement of elements of the financial statements. For example, GFS requires entities to use market values for measuring all items, except loans, whilst IPSASs require or permit cost and current values. The objective of this project is to disaggregate IPSAS information using the GFS sectors, and to disclose information about the GGS. Staff recommend that to achieve the objective of the project, the IPSAS require entities to apply the same recognition and measurement rules that are applied when preparing the consolidated general purpose financial statements except for the consolidation rules established in IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities*.

Consolidation

Staff Recommendation

IPSAS 6 requires all controlling entities (including the whole-of-government) to prepare consolidated financial statements that consolidate all controlled entities on a line-by-line basis. IPSAS 6 also contains a detailed discussion of the concept of control as it applies in the public sector and guidance on determining whether control exists for financial reporting purposes. GFS, however, requires entities to present financial information only

in respect of the general government sector. Public sector entities outside that sector are presented as investments in other sectors, and transactions with entities in other sectors are not eliminated from the statement of government operations.

The GGS controls entities in other sectors. To adopt the IPSAS 6 rules on consolidation for the GGS would result in the presentation of the consolidated whole-of-government financial statements, rather than the GGS financial statements. Staff recommend that the balances and transactions between entities within the GGS be eliminated in accordance with IPSAS 6. Balances and transactions between entities in the GGS and entities in other sectors should not be eliminated, and the GGS should show a line item “investment in other sectors”, as required by GFS.

Should GGS information replace segment information?

Staff Recommendation

IPSAS 18 applies to all entities not just those preparing whole-of-government general purpose financial statements. IPSAS 18, paragraph 9, defines a segment as follows:

A segment is a distinguishable activity or group of activities of an entity for which it appropriate to separately report financial information for the purpose of evaluation the entity's past performance in achieving its objectives and for making decisions about the future allocation of resources.

Staff are of the view that identifying the GGS as a segment would not be appropriate. The GGS encompasses most government activities, therefore information about the GGS alone would not provide sufficient detail to enable users to evaluate the entity's past performance in achieving its objectives. For example, identifying the GGS as a sector would not provide information about a government's performance in achieving its defense, healthcare or educational objectives. Paragraph 24 of IPSAS 18 notes that identifying segments only on the basis of budget-dependent entities (usually equivalent to GGS) and GBEs (usually equivalent to the combined PFC and PNFC sectors), would be unlikely to meet the objectives of IPSAS 18. In addition because the scope of the GGS is narrower than the whole-of-government, important information would be omitted if entities did not present segment information in respect of their whole-of-government financial statements.

GFS also requires entities to disaggregate GFS information using the Classification of Function of Government (COFOG), which is discussed further below.

Staff recommend that IPSAS 18 *Segment Reporting* should not be replaced by the IPSAS on GGS disclosures.

Should GGS information be presented in the IPSAS format or the GFS format?

Staff Recommendation

IPSAS 1 *Presentation of Financial Statements* specifies that certain financial information is to be presented in particular financial statements. GFS also specifies that certain financial information is to be presented in a particular form. The format used to present GFS information in a particular jurisdiction may vary depending on whether the jurisdiction uses the format prescribed by GFSM 2001, ESA 95, EMGDD or SNA 93. The GFS and IPSAS formats are not identical but are not incompatible.

A key difference in presentation is the treatment in GFS of “transactions” and “other economic flows”. Transactions are “interactions between two units by mutual agreement or an action within a unit that is analytically useful to treat as a transaction”. Other economic flows are “changes in the value or volume of an asset or liability that does not result from a transaction”.² Not all items that the IPSASs treat as expenses are treated as transactions in GFS, which means that some items that are included in the IPSAS statement of financial performance would be included in other economic flows under GFS. For example:

- downward revaluations of assets including property, plant and equipment, accounts receivable and investment property;
- impairment losses; and
- provisions.

Staff recommend that, to facilitate the comparison of IPSAS information and GFS information, the IPSAS should require that particular key line items, totals and subtotals be disclosed. This would then allow entities to present the GGS information in the format that is used in the particular jurisdiction for presenting GFS information. Therefore, if the entity wished, it could adopt the GFSM 2001 format or another format. Staff recommend that as a minimum the following should be disclosed:

Balance Sheet Items

- Non-financial assets by major class;
- Financial assets by domicile (foreign or domestic) and major class;
- Monetary gold and special drawing rights in the International Monetary Fund;
- Liabilities by domicile and major class;
- Net worth;

² See GFSM 2001 *Glossary*.

Government Operations Items

- Revenue by major class;
- Expenses by major class;
- Net/Gross Operating Balance;
- Net Acquisition of Non-financial assets by major class;
- Net Lending/Borrowing [GFS];
- Net Acquisition of Financial Assets by domicile;
- Net Incurrence of Liabilities by domicile;

Other Economic Flows Items

- Changes in net worth from other economic flows by type (holding gains or other volume changes);
- Changes in non-financial assets from other economic flows by type;
- Changes in financial assets from other economic flows by type;
- Changes in liabilities from other economic flows by type;

Cash Flow Items

- Cash receipts from operating activities by major class;
- Cash payments for operating activities by major class;
- Net cash inflows from operating activities;
- Cash flows from purchases of non-financial assets by major class;
- Cash flows from sales of non-financial assets by major class;
- Net cash outflow from investments in non-financial assets;
- Cash surplus/deficit;
- Cash flows from the net acquisition of financial assets other than cash by domicile;
- Cash flows from the net incurrence of liabilities by domicile;
- Net cash inflow from financing activities; and
- Net change in the stock of cash.

Should entities electing to disclose GGS disclose the controlled entities that make up the GGS?

Staff Recommendation

IPSAS 6 requires entities preparing consolidated financial statements to disclose a list of the significant controlled entities that are included in the consolidation. Staff are of the view that this provides useful information to users of financial information. To develop an understanding of the relationship between IPSAS information and GGS information, and to better understand the GGS information users need to be able to identify which entities are included in the GGS.

Staff therefore recommend that the IPSAS require entities electing to disclose GGS to disclose which of the entities disclosed under IPSAS 6 are included in the GGS.

Should entities electing to disclose GGS be required to disaggregate GGS information using the COFOG?

Staff Recommendation

GFS requires government expenditure to be disaggregated using the COFOG. Ten broad classes are prescribed, with a number of sub-classes. The ten broad categories of COFOG are:

1. General Public Services
2. Defense
3. Public Order and Safety
4. Economic Affairs
5. Environmental Protection
6. Housing and Community Amenities
7. Health
8. Recreation, Culture and Religion
9. Education
10. Social Protection

Staff are of the view that the requirements of IPSAS 18 should drive the disclosure of segment information, therefore the IPSAS should not require entities electing to disclose GGS information to disaggregate that information using COFOG.

If entities disclosing GGS information wanted to disaggregate GGS information by COFOG, the IPSAS should not prevent them doing so. It is likely that in jurisdictions that focus on GFS information as an important means of conveying information about government finances, the COFOG would be the basis of segmenting the whole-of-government general purpose financial statements.